

REPORT OF EXAMINATION
OF THE
TRANS WORLD ASSURANCE COMPANY

AS OF
DECEMBER 31, 2002

Participating State
and Zone:

California

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San Francisco, California
April 14, 2004

Honorable Alfred W. Gross
Chairman of the NAIC Financial
Condition (EX4) Subcommittee
Commissioner of Insurance
Virginia Bureau of Insurance
Richmond, Virginia

Honorable John Garamendi
Insurance Commissioner
California Department of Insurance
Sacramento, California

Honorable John Morrison
Secretary, Zone IV - Western
Commissioner of Insurance and Securities
Montana Department of Insurance
Helena, Montana

Dear Chairman and Commissioners:

Pursuant to your instructions, an examination was made of the

TRANS WORLD ASSURANCE COMPANY

(hereinafter also referred to as the Company) at its statutory home office and main administrative office, located at 885 South El Camino Real, San Mateo, California 94402.

SCOPE OF EXAMINATION

The previous examination of the Company was made as of December 31, 1998. This examination covers the period from January 1, 1999 through December 31, 2002. The examination was made pursuant to the National Association of Insurance Commissioners' plan of examination. The examination included a review of the Company's practices and procedures, an examination of management records, tests and analyses of detailed transactions within the examination period, and an evaluation of the assets and a determination of liabilities as of December 31, 2002, as deemed necessary under the circumstances.

In addition to those items specifically commented upon in this report, other phases of the Company's operations were reviewed including the following areas that require no further comment: fidelity bonds and other insurance; officers', employees' and agents' welfare and pension plans; growth of company; business in force by states; and sales and advertising.

SUBSEQUENT EVENTS

In June of 1999, Plaintiffs filed a class action complaint alleging seven causes of action, including claims of fraud and unfair business practices, against the Company arising out of its sale and/or administration of its Flexible Dollar Builder life insurance product. The complaint, Heathcock, et al v. Trans World Assurance Company, et al, San Mateo Superior Court, sought compensatory and punitive damages, restitution, disgorgement of profits and injunctive relief. A jury trial for this case began in January 2003 and concluded in April 2003 in favor of the Company.

COMPANY HISTORY

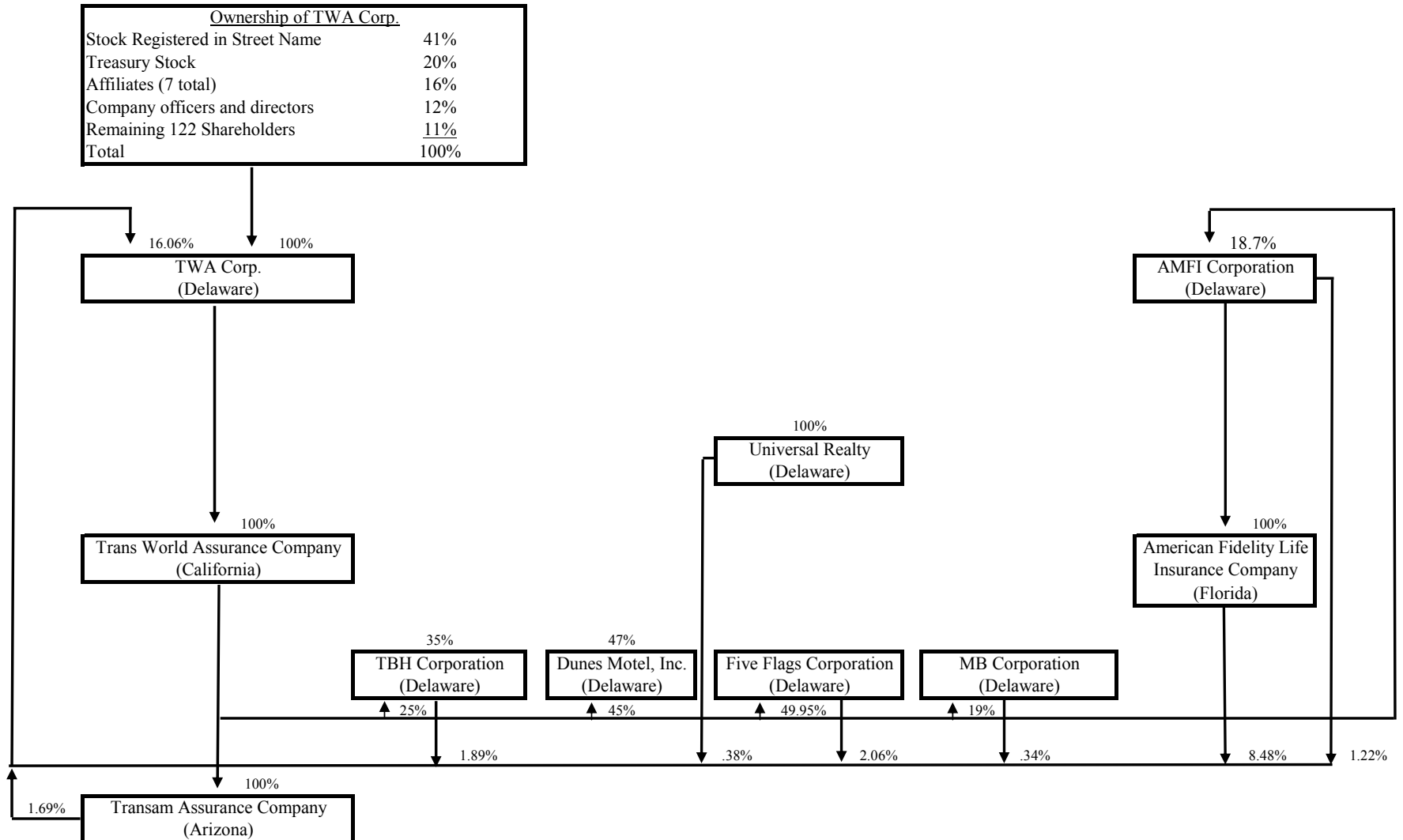
A stock dividend of 12,360 shares, or \$74,160 was paid in 1999, thereby increasing capital stock outstanding to 416,667 shares or \$2,500,002. A cash dividend was paid in 2001 of \$310,704.

MANAGEMENT AND CONTROL

The Company is a member of an insurance holding company system of which TWA Corp., a Delaware insurance holding corporation, is the ultimate controlling entity. Parties owning 10% or more of TWA Corp. include: stock registered in street names 41%; treasury stock 20%; affiliates 16%; and Company officers and directors 12%. The Company has a wholly-owned Arizona life insurance subsidiary, TransAm Assurance Company, and substantial investments in other affiliates. Charles P. Woodbury founded the Company, as well as the following Florida companies which are affiliated with the Company through common ownership or management: American Fidelity Life Insurance Company, Bank of the South, First Navy Bank, and The Warrington Bank.

It can be seen from the following organizational chart that both the Company and American Fidelity Life Insurance Company (AFLIC) are invested in each other through extensive inter-company ownership. At December 31, 2002, AFLIC owned 8.5% of TWA Corp. with a reported value of \$5.6 million. Likewise, the Company owned 18.7% of AFLIC's parent holding company, AMFI Corporation, with a reported value of \$15.9 million. The following organizational chart depicts the Company's relationship within its holding company system and that of AFLIC:

Organizational Chart



Management of the Company is vested in a six-member board of directors. A listing of the members of the board and principal officers serving on December 31, 2002 follows:

Directors

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Earl Bartlett San Mateo, California	Chairman of the Board Trans World Assurance Company
Marilyn W. Hess Pensacola, Florida	Chairman of the Board American Fidelity Life Insurance Company
Charles B. Royals San Mateo, California	President Trans World Assurance Company
Nancy E. Royals Tucson, Arizona	Secretary Trans World Assurance Company
Barbara J. Woodbury La Jolla, California	Vice President Trans World Assurance Company
William P. Woodbury Pensacola, Florida	Vice President First Navy Bank

Principal Officers

<u>Name</u>	<u>Title</u>
Charles B. Royals	President
Mary A. Vrooman	Treasurer
Nancy E. Royals	Secretary
Barbara J. Woodbury	Vice President

Management Agreements

Service Agreement with American Fidelity Life Insurance Company: The Company's only employees are Charles B. Royals, President, and Barbara J. Woodbury, Vice President. The remaining workforce, including the Company's Treasurer and two office staff, are provided by Manpower, Inc., a temporary employment agency. Pursuant to a service agreement, American

Fidelity Life Insurance Company provides services for the Company including underwriting, policy preparation, policyholder service, premium billing, bookkeeping, claims, and other accounting functions. . The Company pays a \$5 fee per in-force policy. The Company justified the fee of \$5 per policy through a cost study.

Service Agreement with TWA Corp. (TWAC): Under this agreement, the Company performs various administrative services for TWAC, such as providing facilities and employee services. TWAC paid the Company \$350 for this service in 2002. The amount seemed reasonable based on the hours recorded.

Consolidated Federal Income Tax Agreement: The Company is a party to a federal income tax agreement with TWAC and is included in TWAC's consolidated federal income tax return. Under the terms of the agreement, the Company prepares a separate tax return and makes payments of any tax liability incurred to TWAC. Per the agreement, any overpayments by the Company are to be held by TWAC and applied to future tax years. This has been a criticism in the last two exam reports. Statement of Statutory Accounting Principle 10, paragraph 13, states that any amounts owed to a reporting entity shall be treated as a loan and nonadmitted if not settled within 90 days of the filing of the consolidated income tax return. Other problems with the agreement include: it has never been signed; it does not include TransAm Assurance Company; and it inadvertently refers to a party named The Continental Corporation. The Company filed an amended agreement with the California Department of Insurance (CDI) in January 2004 and is working with the CDI to obtain approval.

CORPORATE RECORDS

California Insurance Code (CIC) Section 735 states that the Company must inform the board members of the receipt of the examination report. The board should be informed of the report both in the form first formally prepared by the examiners and in the form as finally settled and officially filed by the commissioner. The board must also enter that fact in the board minutes. The Company failed to record any such receipt of the examination report as required by CIC Section 735.

It is the Company's present practice of giving blanket approval to continue investing in a range of investment types (bonds, stocks, mortgage loans) is not in compliance with CIC Sections 1200 and 1201. Although the Company has invested mainly in U.S. Treasuries since 1994, the Company should provide specific references to amounts, facts and the values of securities. It is recommended that the Company implement procedures to ensure future compliance with CIC Sections 735, 1200 and 1201.

TERRITORY AND PLAN OF OPERATION

As of December 31, 2002, the Company was licensed to write life insurance in the Territory of Guam; the District of Columbia; and all states except New Hampshire, New York, Pennsylvania, and Vermont. In addition, the Company is authorized by the Department of Defense to sell life insurance to members of the armed forces on U.S. and overseas bases, and by Japan and Korea to sell life insurance to U.S. citizens living and working for the U.S. Government in those countries. The Company became licensed in the State of Pennsylvania on April 1, 2003.

The Company writes ordinary life and individual annuities. Direct premiums written in 2002 were \$15,017,849. The three largest states for direct premium writings are California (18.6%), Texas (13.9%), and Florida (5.8%). The Company markets its products through a network of 59 general agents and 416 individual agents.

REINSURANCE

Assumed

The Company assumes a small amount of reinsurance from its subsidiary, TransAm Assurance Company and is a participant in the Servicemen's Group Life Insurance Program.

Ceded

The Company cedes to TransAm Assurance Company on a 50% coinsurance basis, the Annual Renewal Term Rider and Guaranteed Insurability Option Riders of policies with limits of risk less than or equal to \$50,000 with the insured's last name beginning with A-L.

Coinsurance

The Company and American Fidelity Life Insurance Company (AFLIC) are parties to three coinsurance agreements under which certain life policies and riders issued by the parties are automatically coinsured on a fifty-fifty basis in excess of each Company's retention. Two agreements cover ordinary life, limited pay life or endowment policies. The Company's retention under these treaties is \$35,000 through December 31, 1997. A separate treaty covers Annual Renewable Term and Guaranteed Insurability Option riders. Retention under this treaty is \$50,000 through December 31, 1997. Effective January 1, 1998, the retention was increased to \$75,000 prospectively on all three contracts.

The Company's reinsurance agreements listed above did not contain insolvency clauses that would comply with California Insurance Code Section 922.2. During the course of the examination, the Company had satisfactorily amended all five agreements.

ACCOUNTS AND RECORDS

Information System Controls

A review was made of the general information systems controls in use by the Company and its data processing service provider, Bank Data, Inc. As a result of the review, weaknesses were noted in the following areas: information systems strategy; security administration; password security; user access administration; emergency response procedures; program change controls; business contingency plan; manual processing procedures; and blank check security. The weaknesses noted

were presented to the Company along with recommendations to strengthen its controls. The Company should evaluate the recommendations and make appropriate changes to strengthen its information system controls. The Company stated that it has addressed or is in the process of addressing the recommendations.

Annual Statement Reporting

During the course of the examination, a number of Annual Statement reporting discrepancies were noted. The Company stated that it has or is in the process of correcting these discrepancies.

Annual Statement/Holding Company Act Disclosures

Inadequate disclosures were noted as follows for the Annual Statement, Notes to Financial Statements (Notes), or the Insurance Holding Company System Annual Registration Statement, Form B (Form B):

1. An organizational chart clearly presenting the identities of and interrelationships among all affiliated persons within the insurance holding company system was not provided with the Form B. The chart or listing should show the percentage of each class of voting securities of each affiliate that is owned, directly or indirectly, by another affiliate. A more detailed chart should be shown in the Annual Statement, Schedule Y.
2. The name and address of any person who holds or owns 10% or more of any class of voting security and number of shares held of TWA Corp. (TWAC), the ultimate controlling person, was not provided in Form B.
3. The following positions were not listed on the biographical information in Form B for Marilyn Woodbury Hess: Director, AMFI Investments, Inc.; President and Director, Freeport, Inc.; Vice President, Treasurer, and Director, S-Cove Corporation.
4. A \$5 million mortgage participation agreement between the Company and American Fidelity Life Insurance Company, an affiliate, was not reported in the Notes, or in Form B.
5. The Company was contingently liable for a \$500,000 line of credit issued to its parent, TWAC. In connection with this, TWAC has pledged 35,256 shares of its own stock valued at approximately \$6.3 million as collateral for the loan. No disclosure was made in Form B, which requires the disclosure of any guarantees or undertakings for the benefit of an affiliate, as well as any pledge of the registrant's or controlling affiliate's stock.

6. No disclosure was made in the Notes or Form B of a class action suit brought against the Company in 1999. The suit was in progress at December 31, 2002.

The Company stated that it has or is in the process of making appropriate disclosures.

FINANCIAL STATEMENTS

The financial statements prepared for this examination report include:

Statement of Financial Condition as of December 31, 2002

Summary of Operations and Capital and Surplus Account
for the Year Ended December 31, 2002

Reconciliation of Capital and Surplus
from December 31, 1998 through December 31, 2002

Statement of Financial Condition
as of December 31, 2002

<u>Assets</u>	<u>Ledger and Nonledger Assets</u>	<u>Nonadmitted Assets</u>	<u>Net Admitted Assets</u>	<u>Notes</u>
Bonds	\$211,881,777	\$	\$211,881,777	
Common stocks	33,080,664		33,080,664	(1)
Mortgage loans on real estate: First liens	6,598,971		6,598,971	
Real estate:				
Properties held for the production of income	3,160,197	175,221	2,984,976	(2)
Properties held for sale	282,602		282,602	
Policy loans	1,113,900		1,113,900	
Cash and short-term investments	4,057,616		4,057,616	(3)
Electronic data processing equipment and software	7,435		7,435	
Federal and foreign income tax recoverable	131,775		131,775	
Life insurance premiums and annuity considerations				
deferred and uncollected on in force business	3,518,426		3,518,426	
Investment income due and accrued	3,716,837		3,716,837	
Amounts due from agents	3,741,754	3,741,754		
Other assets nonadmitted	78,746	78,746		
Aggregate write-ins for other than invested assets	<u>342</u>	<u></u>	<u>342</u>	
Total assets	<u>\$271,371,042</u>	<u>\$ 3,995,721</u>	<u>\$267,375,321</u>	

Liabilities, Capital and Surplus

Aggregate reserve for life contracts		\$ 56,952,665	(4)
Liability for deposit-type contracts		147,619,486	(4)
Contract claims: Life		525,178	
Provision for policyholders' dividends not yet apportioned		11,061	
Premiums and annuity considerations received in advance		33,810	
Commissions to agents due or accrued		52,259	
General expenses due or accrued		69,519	
Taxes, licenses and fees due or accrued		72,749	
Federal and foreign income taxes		55,993	
Amounts withheld or retained by company as agent or trustee		404,485	
Remittances and items not allocated		1,899,280	
Asset valuation reserve		6,895,443	
Aggregate write-ins for liabilities		<u>11</u>	
Total liabilities		214,591,939	
Common capital stock	\$ 2,500,002		
Unassigned funds (surplus)	<u>50,283,380</u>		
Total capital and surplus		<u>52,783,382</u>	
Total liabilities, capital and surplus		<u>\$267,375,321</u>	

Summary of Operations and Capital and Surplus Account
for the Year Ended December 31, 2002

Summary of Operations

Premiums and annuity considerations for life contracts	\$16,067,161
Net investment income	12,164,342
Commissions and expense allowances on reinsurance ceded	4,964
Miscellaneous Income: Charges and fees for deposit type contracts	<u>503,755</u>
Total	<u>28,740,222</u>
Death benefits	2,120,093
Annuity benefits	461,986
Surrender benefits and withdrawals for life contracts	1,181,654
Group conversions	(5,429)
Interest and adjustments on contracts or deposit-type contract funds	10,374,294
Increase in aggregate reserves for life contracts	<u>3,227,004</u>
Total	17,359,602
Commissions on premiums, annuity considerations, and deposit type contract funds	6,379,943
Commissions and expense allowances on reinsurance assumed	21,202
General insurance expenses	3,180,673
Insurance taxes, licenses and fees	545,674
Increase in loading on deferred and uncollected premiums	<u>422,543</u>
Total	<u>27,909,637</u>
Net loss from operations before dividends to policyholders and federal income tax	830,585
Dividends to policyholders	11,247
Federal and foreign income taxes incurred	550,000
Net realized capital gains	<u>58,622</u>
Net income	<u>\$ 327,960</u>

Capital and Surplus Account

Capital and surplus, December 31, 2001	\$50,563,021
Net income	\$ 327,960
Change in net unrealized capital losses	2,041,372
Change in net deferred income tax	269,976
Change in nonadmitted assets and related items	(922,709)
Change in asset valuation reserve	(462,604)
Aggregate write-ins for gains in surplus	<u>966,367</u>
Change in capital and surplus for the year	<u>2,220,362</u>
Capital and surplus, December 31, 2002	<u>\$52,783,382</u>

Reconciliation of Capital and Surplus
from December 31, 1998 through December 31, 2002

Capital and surplus, December 31, 1998, per Examination			\$35,350,960
	<u>Gain in Surplus</u>	<u>Loss in Surplus</u>	
Net income	\$ 8,719,405	\$	
Net unrealized capital gains	10,390,478		
Change in net deferred income tax		171,238	
Change in nonadmitted assets		487,068	
Change in asset valuation reserve		1,036,791	
Cumulative effect of changes in accounting principles	1,094,499		
Capital change: Transferred from surplus	74,160		
Capital change: Transferred to capital		74,160	
Dividends to stockholders		310,704	
Aggregate write-ins for losses in surplus	<u> </u>	<u>766,159</u>	
Total gains and losses	<u>\$20,278,542</u>	<u>\$2,846,120</u>	
Increase in capital and surplus			<u>17,432,422</u>
Capital and surplus, December 31, 2002, per Examination			<u>\$52,783,382</u>

COMMENTS ON FINANCIAL STATEMENT ITEMS

(1) Common Stocks

The Company owns shares in a number of subsidiary, controlled, and/or affiliated (SCA) companies, which in turn, own shares of the Company's ultimate parent, TWA Corp. A reduction for such reciprocal ownership is required per Statement of Statutory Accounting Principles (SSAP) 46, paragraph 14, and the National Association of Insurance Commissioners Securities Valuation Office (SVO) Manual, Part 8, Section 6(c). The value of the reciprocal ownership reduction was calculated to be \$1.4 million at December 31, 2002. The Company made an elimination of approximately \$2 million in its June 2003 Quarterly Statements and has continued to make an elimination since then.

In addition, the Company's practice is to use prior year financials for reporting its SCA valuations to the SVO. It is recommended that the Company review Interpretation 01-22 of SSAP 46. The increase to reflect 2002 equity values in the Company's SCA stock was calculated to be \$718,126. The net decrease to the value of the Company's common stock after the reduction for reciprocal ownership and an increase for 2002 equity values was \$658,924, however, examination adjustments were not made as the amounts were not material.

(2) Real Estate

Real Estate – Unrecorded Grant Deed: The Company reported ownership of a residential property located in San Mateo, California. While the unrecorded grant deed demonstrates the company's ownership, California Insurance Code (CIC) Section 1100 requires that it be recorded in the company's name. The current tenant is an officer of the company and it is recommended that the company file a certificate of exemption under CIC Section 1101(b) (3) with the CDI, which it has agreed to do. In addition, the company should remove the tenant as a beneficiary of any insurance policies concerning the property.

(3) Cash and Short-Term Investments

This asset of \$4,057,616 included \$3,031,054 deposited with two Florida banks, Bank of the South and First Navy Bank. Both banks and the Company share a common director, William P. Woodbury, and were founded by Charles P. Woodbury. The Company should comply with CIC Section 1104.1 by maintaining all monies in excess of legal requirements and reasonable business needs in California.

(4) Aggregate Reserve for Life Contracts and Liability for Deposit-Type Contracts

Pursuant to CIC Section 733(g), a consulting actuary was retained on behalf of the California Department of Insurance (CDI) to perform an actuarial review of the aggregate reserve for life contracts and the liability for deposit-type contracts as reported in the Company's 2002 Annual Statement. Based on the consultant's and CDI's review of the Company's 2002 asset adequacy analysis, the CDI and the Company have concluded that additional work on the Company's year-end 2002 asset adequacy analysis assumptions and procedures is necessary. Until this work is performed, it is not possible to provide an estimate of the degree of deficiency, if any, in the Company's reserves. This work will be applied to the Company's reserves for year-end 2003, rather than requiring further analysis and possible examination adjustment of 2002 reserves.

As a result, the Company actuary has agreed to provide timely further analysis of the Company's 2003 reserves and related assets with sufficient justification of assumptions and procedures so that the Commissioner can be satisfied with his opinion as to the level and adequacy of the Company's reserves.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

Current Report of Examination

Corporate Records (Page 7): It is recommended that the Company's implement procedures to ensure future compliance with CIC Section 735, 1200 and 1201.

Comments on Financial Statement Items – Real Estate (Page 16): It is recommended that the company file a certificate of exemption under CIC Section 1101(b) (3) with the CDI, which it has agreed to do. In addition, the company should remove the tenant as a beneficiary of any insurance policies concerning the property.

Comments on Financial Statement Items – Cash and Short-Term Investments (Page 18): The Company should comply with CIC Section 1104.1 by maintaining all monies in excess of legal requirements and reasonable business needs in California.

Previous Report of Examination

Management and Control (Page 7): It was recommended that the Company amend its Federal Income Tax Agreement to require reimbursement in full from TWA Corp. within 90 days after filing of the consolidated return to be in compliance with CIC Section 1215. A similar recommendation is being made for this examination.

Comments on Financial Statement Items – Real Estate (Page 15): It was recommended that the Company obtain fire insurance coverage on all improved real estate and also an endorsement naming the Company beneficiary on all policies. The Company was able to adequately explain why it doesn't insure some of its lower-valued real estate for fire. The Company still needs to ensure its name is listed as beneficiary on all policies.

Comments on Financial Statement Items – Cash on Deposit (Page 15): It was recommended that all monies in excess of legal requirements and reasonable business needs be maintained in California. A similar recommendation is being made for this examination.

Comments on Financial Statement Items – Aggregate Reserves for Life Policies and Contracts (Page 16): It was recommended that the Company comply with all the findings from the actuarial review. The Company addressed the concerns raised in the actuarial review.

ACKNOWLEDGEMENT

The courtesy and cooperation extended by the Company's officers and employees during the course of this examination are hereby acknowledged.

Respectfully submitted,

Isabel Spiker, CFE
Examiner-In-Charge
Senior Insurance Examiner
Department of Insurance
State of California